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Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-259

BOSTON EDISON COMPANY,

Appellant,

v.

DEPARTMENT OF PUBLIC UTILITIES OF THE COMMONWEALTH OF MASSACHUSETTS, ET AL.,

Appellees.

ON APPEAL FROM THE SUPREME JUDICIAL COURT OF THE COMMONWEALTH OF MASSACHUSETTS

RESPONSE OF BOSTON EDISON COMPANY TO THE DEPARTMENT OF PUBLIC UTILITIES' MOTION TO DISMISS

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In its Brief in Support of its Motion to Dismiss, the Department of Public Utilities appears to misperceive some of the issues raised by Boston Edison's Jurisdictional Statement. Consequently, this response will attempt to clarify those issues. However, issues which have already been adequately framed by the Jurisdictional Statement and the Department's Brief will not be reargued in this response.

I. The Department's Arguments Do Not Alter the Conclusion that the Return on Common Equity Allowed by the Department and Upheld by the Supreme Judicial Court was Confiscatory in Violation of the Fourteenth Amendment and the Decisions of this Court

In its Brief, the Department attempts to rebut the Company's contention that the return on Boston Edison's common equity allowed by the Department and upheld by the Supreme Judicial Court was confiscatory in violation of the Fourteenth Amendment and the established precedent of this Court by misstating the nature of the Company's argument. Thus, the Department at several points in its Brief states that the Company has asserted that it should be "insured" or "guaranteed" a "high profit" sufficient to support a market price for the Company's common stock which is above book value. (Dep't. Br., pp. 10-11.) It even characterizes the Company's argument as an attempt to establish a "rule that a stock must trade at a premium above book". (Dep't. Br., p. 11.) In fact, the Company has argued nothing of the sort.

Instead, Boston Edison contends that if a utility is to be afforded an opportunity to earn a fair and nonconfiscatory return on its investment as defined in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) and *Bluefield Water Works & Improvement Co.* v. *Public Service Commission of the State of West Virginia*, 262 U.S. 679, 693 (1923), then the return allowed must be sufficient, *if earned,* to support a market price for the Company's stock which is at or above book value. However, there can, of course, be no guarantee that such a return, even if allowed, will actually be earned.

In other words, all that the standard established by the Supreme Judicial Court in *New England Telephone and*

Telegraph Co. v. *Department of Public Utilities,* Mass. Adv. Sh. (1976) 2246 at 2259, 354 N.E.2d 860 at 867, and advocated here by the Company requires is that the return which is allowed must be sufficiently high to provide a reasonable likelihood that *if it is earned,* the market price of the Company's stock will equal or exceed book value. An *allowed* return which is below that level is confiscatory. (See Jurisd. St., pp. 13-17.) Nevertheless, once such a return is allowed, it is still up to the utility in question to actually earn it. There clearly can be no guarantee that it will do so.

Boston Edison submits that if the nature of its argument is properly understood, then the conclusion is inescapable that the return on common equity allowed by the Department and upheld by the Supreme Judicial Court was confiscatory in violation of the Fourteenth Amendment and the *Hope* and *Bluefield* standards. The Department's Brief simply fails to address the real issue presented to this Court by the Company's Jurisdictional Statement.

Similarly, the Department's assertion that the Company's equal protection argument is a "self-serving effort designed to diminish the range of inquiry a public utilities commission may undertake in making the difficult judgments underlying cost of equity requirements, and is directly contrary to this Court's ratemaking holdings which emphasize the need for flexibility and good judgment" (Dep't. Br., p. 13) is completely without merit. For to the contrary, the Company's argument attempts to preserve flexibility in the determination of the appropriate return on a utility's common equity by prohibiting the imposition of rigid, arbitrary and irrational classifications among utilities such as the Supreme Judicial Court created in its decision.

Furthermore, the Department's attempt to forestall judicial scrutiny of these arbitrary classifications through its

assertion that the Company is concerned with legislative rather than judicial discrimination is contrary to the actual fact. While Boston Edison's basic complaint most certainly lies with the Department's determination of the cost of equity, that determination could be upheld by the Supreme Judicial Court only through the creation of an arbitrary and unreasonable distinction between utilities conducting "business . . . as usual" and those engaged in construction projects of "limited duration and unprecedented size." It was not the Department which formulated that arbitrary distinction. It was created exclusively by the Supreme Judicial Court. Thus, that distinction is not entitled to the deference normally accorded those economic discriminations which result from legislative action. (See Jurisd. St., pp. 18-19.)[1]

II. The Department's Arguments Do Not Alter the Conclusion That the Supreme Judicial Court Deprived Boston Edison of the Standard of Review to Which it was Constitutionally Entitled

The Department, in disputing Boston Edison's claim that it was entitled to an independent review as to both law and

[1] It might be noted that in its Brief, the Department suggests that Boston Edison no longer has an extraordinary construction program because the projected commercial operation date of Pilgrim 2 has now been deferred until 1985. (Dep't. Br., pp. 4-5.) If that position is maintained, however, then under the Supreme Judicial Court's classification system, it follows that Boston Edison must be classified as a utility conducting "business . . . as usual." That in turn means that under the standards suggested in the Supreme Judicial Court's opinion, the allowed return on equity is admittedly confiscatory for it was held not to be sufficient, if earned, to support a market price for the Company's stock at least equivalent to book value. See *App.* 14. Yet a utility conducting "business . . . as usual" is entitled to such protection from confiscation by dilution. See *App.* 15-16.

fact on the confiscation issue, appears to have misapprehended the nature of the Supreme Judicial Court's findings with respect to confiscation. It is true that the Court did purport to conduct an independent review as to both law and fact with respect to whether or not the allowed *rate of return* was confiscatory. It concluded that it was not. However, it never examined the question of whether or not the *rates* allowed by the Department were confiscatory. These are two very distinct issues. For even if the allowed rate of return is reasonable, the *rates* may nevertheless be confiscatory if they are established in a manner which will not allow the Company a reasonable opportunity to earn the rate of return purportedly allowed.

In other words, even if the Department should allow a reasonable rate of return, it may so reduce the rate base to which that rate of return is applied as to render the allowed rate of return illusory. Similarly, cost of service adjustments which disallow real expenses and accept fictitious revenues will produce a bottom line revenue requirement, and therefore rates, which are confiscatory regardless of the level of the allowed rate of return.

That is precisely what Boston Edison contends happened in this case. Through unwarranted and unreasonable rate base and cost of service adjustments, the Department established rates at a level which provided the Company with absolutely no realistic possibility of earning the allowed rate of return. Therefore, since the *rates* were confiscatory, Boston Edison was entitled to independent review as to both law and fact with respect to the cost of service and rate base adjustments.

The Supreme Judicial Court, to be sure, stated in its opinion that confiscation had not been established, but it

plainly did so only because it had determined that the *allowed rate of return* was fair and reasonable, *not* because it had determined that the Company's revenues and *actual return* were adequate. See *App.* 16. In fact, it appears from the decision that the Court never considered the *actual* return earned by the Company and the relevance of those actual financial results on the confiscation question. If the extensive evidence on that subject (see, *e.g.*, Jurisd. St., pp. 10-12) had been considered, however, it clearly demonstrated that despite the Department's purported allowance of a 13% return on the Company's common equity, Boston Edison consistently earned far less than this allowed return. It did so because the *rates* themselves were confiscatory and had been established only after unwarranted and unreasonable rate base and cost of service adjustments had been made which ensured that the Company would not have a realistic opportunity to earn the allowed return.

In short, therefore, the Supreme Judicial Court's finding that the Company had not established the "indicia" of confiscation clearly resulted from the Court's confusion between the *allowed* rate of return and the return which the Company could *actually earn*. Under such circumstances, the Supreme Judicial Court's failure to provide an independent review as to both law and fact with respect to the various rate base and cost of service adjustments deprived Boston Edison of the standard of review to which it was constitutionally entitled.

III. Boston Edison is Constitutionally Entitled to Compensation for Revenues Lost as the Result of Prolonged and Unreasonable Delay in the Administrative and Judicial Process

In contending that the Company's argument that it is constitutionally entitled to a restoration of the revenues lost through prolonged and unreasonable delay in the administrative and judicial process fails to raise a substantial federal question, the Department focuses principally upon only one aspect of the Company's claim — the claim for revenues lost through delay in the administrative process. It advocates an immutable rule that rates are purely prospective in nature and cannot compensate the utility for losses which occurred during the statutory suspension period. (Dept. Br., pp. 18-19.) Boston Edison espouses a more flexible standard in arguing that a utility is entitled to compensation for that confiscation which took place during the suspension period which would not have occurred *but for* the calculated and unreasonable delay by the regulatory commission in acting upon the utility's rate request.[2] In any event, the difference in the parties' respective positions on this point is now adequately framed by the papers before this Court.

The Department fails to address directly, however, the Company's further claim that it should be compensated for the revenues lost as a result of delays in securing judicial review of the Department's decision.[3] This point is of ut-

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[2] It might be noted that in a previous case the Supreme Judicial Court suggested that a utility in such a situation was constitutionally entitled to relief. See *Boston Gas Co.* v. *Department of Public Utilities*, 368 Mass. 51, 54 (1975).

[3] The magnitude of this loss is suggested at pp. 27-28 of the Jurisdictional Statement.

most significance, for even if no taking of Edison's property could have occurred until such time as the confiscatory rates were established by the Department, the Company is nevertheless entitled to compensation for the taking which occurred during the period that those confiscatory rates were in effect and the subject of further appellate proceedings. See *Potomac Electric Power Co.* v. *Public Service Commission,* 380 A.2d 126, 148-149 (D.C. 1977).[4]

Moreover, contrary to the Department's suggestion (see Dept. Br., p. 19), the fact that a new rate decision was issued some eighteen months after the Department's original order but before the Supreme Judicial Court had rendered its decision in the appeal from that original order does not destroy the Company's claim for compensation. The new rate order merely suspended all or part of the ongoing confiscation which resulted from the original order.[5] In short, the intervening rate decision by the Department cannot alter the incontrovertible fact that during the period that the confiscatory rates were in effect, the Company experienced a real and measurable taking of its property for which it is constitutionally entitled to compensation.

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[4] The Department argues, of course, that the Supreme Judicial Court found that the rates allowed by the Department were not confiscatory. As pointed out previously, however (*supra,* pp. 5-6; Jurisd. St., p. 22), that finding is directly contrary to the evidence before the Court and results from the Court's mistaken reliance on the allowed rate of return as the sole factor to be considered in determining whether or not the *rates* were confiscatory.

[5] That this confiscation was substantial is reflected by the fact that in 1977, while the appeal was pending and before any new rate order had been entered by the Department, the Company's earnings plummeted to $2.06 per share. This provided a return on equity of only 6.33%. The dividend payout ratio in 1977, with no change in the amount of the annual dividend, was 118%. (*Compare* Jurisd. St., p. 11.)

CONCLUSION

For the reasons set forth in the Jurisdictional Statement and in this Response to the Department's Motion to Dismiss, Boston Edison Company respectfully submits that this Court should deny the Department Motion to Dismiss and note probable jurisdiction to determine the substantial questions presented.

Respectfully submitted,

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